225177

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 680 (Sub-No. 1)

SUPPLEMENTAL REPORT ON CAPACITY AND INFRASTRUCTURE INVESTMENT

REPLY COMMENTS OF ARKANSAS ELECTRIC COOPERATIVE CORPORATION REGARDING SUPPLEMENTAL REPORT ON CAPACITY AND INFRASTRUCTURE INVESTMENT CONDUCTED BY CHRISTENSEN ASSOCIATES

Michael A. Nelson
131 North Street
Dalton, MA 01226
(413) 684-2044

Transportation Consultant

Eric Von Salzen
McLeod, Watkinson & Miller
One Massachusetts Avenue, N.W.
Suite 800
Washington, DC 20001
(202) 842-2345

Counsel for Arkansas Electric Cooperative Corporation

Dated: May 28, 2009

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 680 (Sub-No. 1)

SUPPLEMENTAL REPORT ON CAPACITY AND INFRASTRUCTURE INVESTMENT

REPLY COMMENTS OF ARKANSAS ELECTRIC COOPERATIVE CORPORATION REGARDING SUPPLEMENTAL REPORT ON CAPACITY AND INFRASTRUCTURE INVESTMENT CONDUCTED BY CHRISTENSEN ASSOCIATES

Introduction

Pursuant to the Board's Notice dated April 8, 2009, Arkansas Electric Cooperative Corporation (AECC) [1]/ replies to the comments submitted by the Association of American Railroads[2] regarding the report prepared by Christensen Associates, Inc., under contract to the Board, entitled, *Supplemental Report to the U.S. Surface Transportation Board on Capacity and Infrastructure Investment*, released on April 8, 2009 ("*Supplemental Report*").[3]

[1]/ AECC's interests in this proceeding were described in "Comments of Arkansas Electric Cooperative Corporation Regarding Supplemental Report on Capacity and Infrastructure Investment Conducted by Christensen Associates" (May 8, 2009) ("AECC Comments").

[2] "Comments of the Association of American Railroads" (May 8, 2009) ("AAR Comments").

[3] This report supplements an earlier report by Christensen Associates, *A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals That Might Enhance Competition*, released in November 2008.

As described in detail in AECC Comments, the *Supplemental Report* effectively voids the oft-repeated rail industry argument that future capacity needs cannot be satisfied at current rate levels, so that higher rates are required to support needed infrastructure investments. This argument formed the central theme of the report on infrastructure needs prepared for AAR by Cambridge Systematics (*CS Report*).[4]

The AAR Comments seek to create the impression that the railroads' capacity arguments are not really dead, but this attempt does not survive even a cursory review of the facts, as AECC demonstrates in its following reply comments.

Reply Comments

CS Report origins – The AAR solemnly recounts how the *CS Report* "...was commissioned by the AAR at the request of the National Surface Transportation Policy and Revenue Study Commission", and describes how "[t]he Commission was...charged with completing a comprehensive study of the U.S. surface transportation system and the Highway Trust Fund, then developing a conceptual plan, with alternative approaches, to ensure that this system continues to serve the needs of the United States."

Notwithstanding the noble purpose and pedigree laid out by AAR, the fact is that the *CS Report* was developed by the railroads in secrecy and was inserted into the Commission's records with no opportunity for public scrutiny of its methods or assumptions. Commission records show the *CS Report* was received as a submission

[4] Cambridge Systematics, National Rail Freight Infrastructure Capacity *and* Investment Study, prepared for the Association of American Railroads (September 2007).

sponsored by Matt Rose of BNSF Railway,[5] who had been appointed to serve as one of the twelve Commissioners. Commission records further indicate that the completion of the study in September 2007 fell several months <u>after</u> the close of the Commission's meetings and public hearings.[6] Indeed, given the AAR's representation that the *CS Report* was completed in two months, it was apparently not even <u>begun</u> until after the close of all of the Commission's meetings and public hearings. The *CS Report* should be treated as what it is, a position paper for the railroad industry. It is entitled to no deference by virtue of its association with the Commission.

<u>*CS Report* data limitations</u> – The *CS Report* makes frequent reference to the fact that it relied on the freight volume projections presented in the U.S. Department of Transportation's Freight Analysis Framework (FAF). However, AECC has been unable to locate any place in the *CS Report* text, or in the railroads' characterizations of the *CS Report* results between the time of its release in September 2007 and the filing date of <u>AAR Comments</u> (May 8, 2009), where any concerns, caveats, or limitations were expressed pertaining to possible inaccuracies of the FAF volume projections. The *CS Report* does itemize omissions that, if incorporated, would tend to <u>increase</u> the forecast volumes, but is basically silent with regard to factors that would have the opposite effect. Likewise, the rail industry's characterizations of the *CS Report* have generally emphasized the largest of the investment estimates it contains, even to

[5] See http://transportationfortomorrow.org/final_report/pdf/volume_3/volume_3_table_of_contents.pdf at page 6, Section 6.

[6] See http://transportationfortomorrow.org/activities/ .

the point of disregarding the important roles of current investment patterns and productivity improvements in fulfilling such needs, as described in the *CS Report*.

AAR now claims it "...has long recognized that there were limitations on what could be done in the time allowed and with the external constraints placed on the work" of the *CS Report*. However, this supposed recognition did not stop AAR, after the *CS Report* was released, from broadcasting the overstated FAF volume forecasts to anyone who would listen. The disingenuous nature of AAR's claimed recognition of the "limitations" of the high FAF volume forecasts is belied by AAR's unconditioned reliance on those forecasts for more than a year, and its engagement of Cambridge Systematics to conduct a "more comprehensive" follow-up study only after the Board's engagement of Christensen Associates to conduct the *Supplemental Report*. Indeed, AAR continued to present the FAF results as authoritative two months after the Board's announcement, which is also the same time AAR claims to have commissioned Cambridge Systematics to fix them.[7]

It is only through the Board's initiative and the *Supplemental Report* that stakeholders now have a much clearer view of the problems associated with the FAF forecasts and the (lack of) significance of current and future rail capacity constraints as determinants of appropriate rail rate levels.

[7] See, for example, the Congressional testimony of AAR President and CEO Edward Hamberger at the end of October, 2007. http://www.aar.org/~/media/AAR/Testimony/Written/AAR%20on%20Infrastructure%20Oct%202008.ashx .

<u>Economic conditions</u> – AAR cites the current economic downturn as if it were some type of "speed bump" that has temporarily slowed the approach of the capacity crises the rail industry projected so breathlessly based on the *CS Report*. However this argument basically asks the Board to disregard the detailed documentation provided by the *Supplemental Report* regarding considerations unrelated to the downturn, and to give greater weight to outdated forecasts than to current ones. For example, even if there were no recession, the long-term growth potential of coal traffic has been limited by considerations related to carbon footprint issues.

Department of Energy/Energy Information Administration (DOE/EIA) data indicate that the historical growth rate in coal production between 1980-2007 was 0.9 percent per year, and the authoritative projections contained in DOE/EIA's most recent Annual Energy Outlook (2009) indicate an expected growth rate in coal production of 0.6 percent per year from 2007-2030.[8] Neither of these numbers lends support to the assumed 2.1 percent annual coal traffic growth rate embedded in the FAF projection utilized in the *CS Report*.

The fact that the projections contained in more recent forecasts may be lower than those in older forecasts does not imply that the former are less accurate. Indeed, because newer forecasts are able to incorporate more recent information, they have an intrinsic reliability advantage over older forecasts. While AAR attempts to disparage the more recent values as the "lowest possible forecast", they are, all else

---

[8] See, for example, http://www.eia.doe.gov/oiaf/aeo/coal.html .

equal, the most reasonable values to use. AAR may wish that we "didn't know now what we didn't know then", but that doesn't mean that it's reasonable to use FAF forecasts that are outdated and inconsistent with both historical experience and current projections from authoritative independent sources.

CS Report study design – AAR attempts to excuse the fact that the capacity investments projected in the *CS Report* were not subjected to cost-benefit analysis (and thus might not actually be made) by claiming that "the focus of the [*CS Report*] was, by design, the performance of the network as whole, not specific individual locations." This characterization is flatly contradicted by the *CS Report* itself, which indicates that the study entailed detailed analysis of over 52,000 miles of the primary rail freight corridors in the U.S., including corridor- and railroad-specific information regarding the three "dominant factors" that determine capacity – the number of tracks, control system and mix of train types.[9] The *CS Report* further describes how it includes the cost of designing and constructing specific line and facility expansions, including:

> Line expansion:
>
> - Upgrades to the Class I railroad system mainline tracks and signal control systems;
> - Improvements to significant rail bridges and tunnels; [footnote omitted]
> - Upgrades to Class I railroad secondary mainlines and branch lines to accommodate 286,000-pound freight cars; and
> - Upgrades to short line and regional railroad tracks and bridges to accommodate 286,000-pound freight cars.

---

[9] Even the AAR Comments indicate that "[t]he AAR and Cambridge Systematics collected and analyzed data submitted by individual railroads. Much of this railroad specific data — including detailed line characteristics and traffic routing decisions — is highly sensitive commercial information…".

Facility expansion:

- Expansion of carload terminals, intermodal yards, and international gateway facilities owned by railroads; and
- Expansion of Class I railroad service and support facilities such as fueling stations and maintenance facilities.[10]

While the principal *CS Report* output obviously was a network-level estimate of investment requirements, that estimate was derived from a methodical and detailed examination of investment requirements at specific locations. If the investment requirements at specific locations are overstated due to the absence of cost-benefit analyses, AAR cannot duck the mathematical fact that the network-level total is overstated by a corresponding amount.

Need for investment – AAR cites the fact that the railroads will still have investment needs as if that somehow transcends the destruction of the *CS Report* findings. No one disputes that future investments will be needed – the entirety of the issue, as explicitly described in the *CS Report*, is whether or not such investments will be sustainable *in the context of established pricing and investment practices*, and opportunities for productivity improvement. Undeterred by the fact that the evidence does not indicate the existence of a problem, AAR simply turns its back on the evidence, and argues that a need for any investment is somehow equivalent to a need for extraordinary increases in investment. AAR does not – and cannot – provide a credible rationale for ignoring the carriers' demonstrated ability to generate capacity

[10] *CS Report* at page 3-1.

investments and productivity improvements at current rate levels, which its own study properly identified as major sources of future capacity expansion.

Timing of investments – AAR argues that public policy should take a long-term view to safeguard the interests of the rail network. However, it then argues that the railroads won't make any investments in future capacity expansion until the traffic materializes, or is imminently expected to appear.

AAR does not appear to recognize the inconsistency of these two positions. If the railroads can and do wait until the time capacity expansions are needed before investing in such capacity, why should public policy tolerate rate increases far in advance of the time when capacity expansions might actually be considered, and without any assurances that such investments will actually be made? AAR never provides a coherent answer to that question. Moreover, even if longer-term perspectives are needed, AAR fails to address why it would not be preferable for the Board to motivate the adoption of such perspectives by the railroads (e.g., through more aggressive requirements regarding the common carrier obligation and more severe consequences for service failures) rather than place the burden outside the industry.

Traffic rationing – AAR makes reference to the "rationing" of capacity when capacity is constrained. AECC Comments (at pages 4-5) already pointed out how the findings of the *Supplemental Report* refute the proposition that the railroads in recent years have been operating in a capacity-constrained environment that necessitated the use of increased differential pricing to ration capacity, how the proposition that future volume growth will inherently require higher rates has no foundation and runs contrary to actual experience, and how due to limited future volume growth, PRB coal is unlikely to even enter the picture of future rail capacity expansion requirements. Further discussion of these points presented in AECC Comments is incorporated herein by reference.

Traffic mix – AAR observes that changes in the mix of trains with different service levels will put pressure on rail capacity, but completely ignores the role of productivity improvements, such as the implementation of Positive Train Control (PTC), in addressing this issue. Further discussion of this issue presented in AECC Comments (at page 4) is incorporated herein by reference.

CS Report II – In light of the foregoing, the unresolved status of the new Cambridge Systematics study commissioned by AAR raises some public interest concerns. On the one hand, if Cambridge Systematics has had seven months to work on its new and improved study, presumably AAR should be in a position to identify substantive shortcomings that hypothetically might exist in the *Supplemental Report*. The absence of substantive criticism from AAR leads to the reasonable inference that *CS Report II* is reaching findings that are not materially different from those presented in the *Supplemental Report*.

However, as described previously, AAR now has a demonstrated history of introducing self-serving capacity studies in a way that shields them from effective scrutiny, and of having no qualms about parading such studies before Congress without disclosing their "limitations". If AAR elects to introduce *CS Report II* in a manner that shields it from critical review, public interest considerations would be raised that warrant Board attention.

The Board has responsibility for protecting the public interest as defined under the national transportation policy. To the extent that the Board accepts the findings of the *Supplemental Report*, such findings represent the Board's conclusions regarding several important issues pertaining to volume, capacity and infrastructure. It would be detrimental to the public interest if the industry were to circulate findings from *CS Report II* that improperly sandbagged, undermined or trumped the Board's legitimate authority and findings regarding capacity and infrastructure issues.

To prevent this outcome, the Board should require that the railroads report to it any release of *CS Report II* that occurs outside of Board proceedings, and should provide a forum that would enable reconciliation of the results of that report with *Supplemental Report*.

<u>Synthesis</u>

Three decades ago, the railroads could in some cases legitimately rely on the proposition that their questionable financial health limited their ability to fund meritorious infrastructure improvements. However, that environment no longer exists. By all accounts, the Class I rail industry is near, at, or beyond the threshold of revenue adequacy that was so far off in the distance at the time of the Staggers Act.

Rather than continue posturing as relics from the past, it is time for the railroads to acknowledge and embrace the success they have achieved with the support of the Board (and ICC), and even shippers, who, like AECC, have made large investments in equipment and facilities that have enabled the dramatic productivity improvements and cost reductions that underlie much of the railroads' economic renaissance. This will facilitate constructive dialogue needed to transition public policy in this changed environment.

Respectfully submitted,

Eric Von Salzen

Eric Von Salzen
McLeod, Watkinson & Miller
One Massachusetts Avenue, N.W.
Suite 800
Washington, DC 20001
(202) 842-2345

Counsel for Arkansas Electric Cooperative Corporation

Michael A. Nelson
131 North Street
Dalton, MA 01226
(413) 684-2044

Transportation Consultant

Dated: May 28, 2009